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# The Wrong Side of the Mountain: A Comment on Bad Faith's Unnatural History

Robert H. Jerry, II\*

Professor Abraham is correct that the current climate for bad faith liability has a different feel than the one that existed as recently as ten years ago, and it cannot be doubted that, as he explains with his typical incisiveness, the climate has in fact changed in many ways.<sup>1</sup> The ebb and flow in the tumult in bad faith law over the last three decades has been remarkable in and of itself, but some of the most startling aspects of this history involve the early turns this tumult took. Much like an orienteer who makes a two-degree error at the beginning of a hike and within a few hours finds herself on the wrong side of the mountain, the choices courts made when first using their compasses ordained a rather divergent path from the trail that might have made more sense. If the trail we now traverse seems to have become easier, perhaps we should continue to follow it and hope that it connects with the original trail some miles ahead. The other choice requires much effort: climbing up and over the mountain to get back on the right route. I take it as a given that we are unable to go back to the junction and start over, although if lost in the mountains, this is what I would do. Like Professor Abraham, I want more data about where we are,<sup>2</sup> for without better information, it is difficult to have much confidence about choosing where to go.

In this Comment, I will argue that courts have ignored bad faith's contractual heritage and have undervalued contract law's ability to respond to insurer misconduct. To draw upon Professor Powers's thoughtful analysis, I believe that courts invoked the tort paradigm before it was clear that

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1. Kenneth S. Abraham, *The Natural History of the Insurer's Liability for Bad Faith*, 72 TEX. L. REV. 1295, 1295 (1994).

2. *Id.* at 1315.

the contract paradigm was inadequate.<sup>3</sup> For lack of data, I will stop short of recommending where we should go from here, but I will suggest that our behavior in the face of bad faith liability in tort may have changed no less than the environment and that the perceived relative calm in the tort's current development is tenuous in some respects.

## I. Bad Faith's Ancient Lineage

The tort of bad faith is a relative newcomer, with a history dating only to the late 1950s; indeed, the tort was not taken seriously until the 1970s.<sup>4</sup> But it is probably also fair to say that, in the contract field, most courts and commentators did not appreciate until the latter half of this century that the duty of good faith and fair dealing is an independent duty implied in every contract or that it possesses the same legal significance as other duties expressly created by the parties.<sup>5</sup> This broad duty of good faith went beyond the principle that courts were accustomed to applying in other contexts. The more limited principle of good faith had been used, for example, to provide a constraint on parties who had no duty to perform unless they were satisfied with the other party's performance<sup>6</sup> and to limit the discretion of a party to whom authority had been given in the agreement to specify a contract term.<sup>7</sup> This relatively late acknowledgement

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3. See William Powers, Jr., *Border Wars*, 72 TEX. L. REV. 1209, 1224-25 (1994) (describing the contract paradigm as "the ideology of autonomy and consent" and the negligence paradigm as one that "fills in when we do not have an option to use contract law").

4. In *Comunale v. Traders & General Insurance Co.*, 328 P.2d 198 (Cal. 1958), the California Supreme Court, while considering whether the statute of limitations had run on the insured's claim of the insurer's failure to defend and to respond appropriately to the plaintiff's settlement offer, stated in dictum that a wrongful refusal to settle had generally been treated as a tort. *Id.* at 203. It was not until 1967 that the court accepted its own invitation to find the breach of the contractual covenant of good faith and fair dealing to be a tort. See *Crisci v. Security Ins. Co.*, 426 P.2d 173, 177 (Cal. 1967) (en banc) (stating that liability for breach of an insurer's implied covenant of good faith and fair dealing will be imposed for unreasonable rejections of settlement offers, regardless of bad faith on the part of the insurer). In 1973, the California Supreme Court extended this analysis to first-party insurance, holding that the breach of the implied covenant in the first-party setting is a tort. *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1038 (Cal. 1973) (en banc).

5. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); see also *infra* notes 90-101 and accompanying text (tracing good faith's emergence as a duty implied in every contract).

6. If an agreement conditions a party's duty to perform on its satisfaction with the other party's performance, there is considerable potential for overreaching by the party whose duty is conditioned; the obvious temptation is to feign dissatisfaction in order to escape other contract obligations. Thus, courts require the party whose duty is conditioned to use "good faith" when forming a judgment regarding her satisfaction with the other's performance. *E.g.*, *Mattei v. Hopper*, 330 P.2d 625, 627 (Cal. 1958) (en banc); *Devoine Co. v. International Co.*, 136 A. 37, 38 (Md. 1927).

7. Contracting parties often leave one of the parties the option to specify how an open term of the contract will be filled. This could involve something as simple as the parties' agreement that the seller shall determine how a shipment of goods will be transported, or it may involve more complicated

of the full import of the duty of good faith and fair dealing has created much excitement, but the duty has an ancestral heritage long predating the modern conceptualization. Indeed, what is most surprising about this history is how little attention we have paid to it.

### A. *Early Conceptualizations of Good Faith*

1. *Roman law.*—The essence of a duty of good faith existed at least two thousand years ago in the law of the Romans.<sup>8</sup> To summarize what others have discussed in detail elsewhere, Roman law is credited with recognizing that a promise can give rise to a duty.<sup>9</sup> Because a duty implies a reciprocal right that can be enforced in appropriate circumstances, the Romans' recognition that promises can create duties amounted to the recognition of promissory liability. Yet during a millennium of evolution, Roman law never articulated a general theory of contract pursuant to which exchanges of promises would be enforced absent formalities or a return performance.<sup>10</sup>

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relationships, as is the case with output or requirements contracts. For example, if a buyer promises to purchase all of its requirements for a particular good from a seller, the buyer retains to some degree the discretion to determine the quantity of its requirements, which defines the scope of the seller's obligation to the buyer. To constrain the buyer's discretion and to shield the seller from having unreasonable demands imposed upon it, the buyer is required to determine its requirements in good faith. *See, e.g.,* *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320, 322-23 (N.Y. 1975) (holding, in the context of an output contract, that the defendant had terminated production in good faith and thus had no further obligation to perform); *Dickey v. Philadelphia Minit-Man Corp.*, 105 A.2d 580, 583 (Pa. 1954) (holding that a lessee under contract to pay rent based on a percentage of sales, subject to a minimum rent amount, could maintain possession of the property after ceasing the business upon which the sales provision was based, so long as the lessee continued to pay the minimum rent and the cessation was in good faith).

8. For a different perspective on this issue that reaches the same conclusion, see Nicola W. Palmieri, *Good Faith Disclosures Required During Precontractual Negotiations*, 24 SETON HALL L. REV. 70, 80, 80-83 (1993) (tracing the requirement of good faith to primordial societies and asserting that as civilizations progressed, "good faith and fairness remained the highest criterion for evaluating contractual obligations").

9. E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 588 (1969); *see* HENRY S. MAINE, *ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN IDEAS* 358 (10th ed. 1930) ("[I]t cannot be doubted that [consensual contracts in Roman law] constituted the stage in the history of Contract-law from which all modern conceptions of contract took their start.").

10. Farnsworth, *supra* note 9, at 590. It may be inaccurate to suggest, however, that the Romans failed to develop a general theory of contract or to establish a "general principle of enforceability of promises." *Id.* at 588. Professor Alan Watson argues forcefully that

from very early times the Romans did have a method—the stipulatio in fact—by which parties could agree to create any obligation which was not positively unlawful. If one dares to speak anachronistically, one can say that in very early times the Romans did have a general theory of contract, not a law of individual contracts.

ALAN WATSON, *THE EVOLUTION OF LAW* 6-7 (1985). Watson believes, however, that this general theory disappeared later in the Roman experience. *Id.* at 7-28.

Under Roman law, a promise was not enforceable unless it fell within one of a few specific categories in which the law had devised narrow theories for enforcing the promise.<sup>11</sup> *The Institutes of Justinian and Gaius*<sup>12</sup> divided the Roman law of promissory liability into four categories, one of which was known as "consensual contracts" (*consensu contrahitur obligatio*).<sup>13</sup> The consensual contract developed later in Roman history than the other three categories, emerging at a time when population increases and burgeoning commerce required a less cumbersome means of creating promissory obligations.<sup>14</sup>

11. See W.W. BUCKLAND & ARNOLD D. MCNAIR, *ROMAN LAW & COMMON LAW: A COMPARISON IN OUTLINE* 195, 193-96 (2d ed. 1952) ("[T]he attitude of the Roman law can be fairly stated by the proposition that an agreement is not a contract unless the law, for some reason, erects it into one."); F.H. LAWSON, *A COMMON LAWYER LOOKS AT THE CIVIL LAW* 113 (1955) (asserting the general principal that "[a] nude pact did not beget an action").

12. *The Institutes of Justinian and Gaius* was a four-book manual, partly historical and partly theoretical, that briefly but comprehensively summarized the whole body of Roman law. RUDOLPH SOHM, *THE INSTITUTES: A TEXTBOOK OF THE HISTORY AND SYSTEM OF ROMAN PRIVATE LAW* § 6, at 16 (James C. Ledlie trans., 3d ed. 1970). The manual was designed to serve as a prefix to a codification of Roman law in a Digest—a collection of excerpts from the writings of Roman jurists—and a Code—a collection of imperial decrees and the laws. *Id.* The Institutes nevertheless had the full force of law, as did the Digest and the Code. *Id.* Justinian's imperial minister, Tribonian, and two professors under his supervision, Theophilus and Dorotheus, composed the Institutes, drawing heavily on the earlier Institutes of Gaius and *Res Quotidianae* of Gaius. *Id.* § 21, at 122.

13. In addition to the consensual contract, Roman law recognized these three categories: real contracts (*re contrahitur obligatio*), verbal contracts (*verbis contrahitur obligatio*), and literal contracts (*litteris contrahitur obligatio*). LAWSON, *supra* note 11, at 113; FRITZ SCHULZ, *CLASSICAL ROMAN LAW* 468-69 (1951). The four-part categorization, which may have been invented by Gaius, was not well contrived; it was at least accurate, however, in that no "contracts" other than those listed in the categorization were recognized in the classical period. SCHULZ, *supra*, at 469. By the sixth century, a group of contracts outside the four-part categorization called "innominate contracts" were recognized under Justinian's law. LAWSON, *supra* note 11, at 131. What distinguished these contracts was "a new principle, i.e. that in an agreement for mutual services performance on one side binds the other. The essence is the *quid pro quo*, absent in the contracts *re*." W.W. BUCKLAND, *A TEXT-BOOK OF ROMAN LAW FROM AUGUSTUS TO JUSTINIAN* 521 (3d ed. 1963) [hereinafter BUCKLAND, *TEXT-BOOK OF ROMAN LAW*]. Because innominate contracts required full performance by one side, the action was limited, but the action was different in that it was not limited to specific kinds of transactions. *Id.* at 521-26. Nevertheless, whatever potential the innominate contract had to evolve into a general theory for enforcing an exchange of promises absent formalities was unrealized in Roman law. See *id.* (outlining the various types of innominate contracts, each of which required the presence of an underlying formal contract).

14. WILLIAM L. BURDICK, *THE PRINCIPLES OF ROMAN LAW AND THEIR RELATION TO MODERN LAW* 442 (1938); Reinhard Zimmermann, *Roman-Dutch Jurisprudence and Its Contribution to European Private Law*, 66 *TUL. L. REV.* 1685, 1689-91 (1992). The formal requirements of the other kinds of contracts limited their usefulness. For example, the stipulation—the only important kind of verbal contract—bound only one party to a promise and thus was unwieldy for bilateral exchanges. There were only a few rules that had to be followed to create a stipulation, but those rules had to be observed exactly: (1) both parties had to speak to each other (not give signs or write), and both had to be capable of understanding each other; (2) both parties had to be present during the entire act; (3) the promisee had to first ask a solemn question to the promisor, such as "*Centum mihi dari spondes?*" (Do you undertake?), and the promisee had to answer immediately with a word such as "*Spondeo*" (I undertake); and (4) the answer had to correspond precisely to the question. Thus, if the promisee

The classical *ius civile*<sup>15</sup> recognized four kinds of consensual contracts: sale (*emptio venditio*), hire (*locatio conductio*), partnership (*societas*), and mandate (*mandatum*).<sup>16</sup> Although these were the only categories of consensual contracts enforced, the scope of these categories was extremely wide, covering "almost all the normal operations of Roman business, except the loan of money and certain types of security."<sup>17</sup> Moreover, consensual contracts evolved in ways that served the needs of Rome's increasingly complex commerce. Substantively, however, the promissory obligation in these contracts was "flexibly defined by reference to good faith; the judge had a wide discretion which enabled him to take into account the particularities of the individual case."<sup>18</sup> The *formulae*, standardized documents used to "authorize" a judge to enter a decree in a dispute,<sup>19</sup> invariably treated the question of the breacher's liability in consensual contract disputes as a question of law<sup>20</sup> and contained the

spoke in Latin, the promisor could not speak in Greek. If the promisor asked "*Dari spondes?*" the promisee had to answer "*Spondeo*," not "*Promitto*" or "*Accipio*." SCHULZ, *supra* note 13, at 473-74. Real contracts were similarly cumbersome; they required delivering a corporeal thing, which the recipient was bound to restore. See SOHM, *supra* note 12, § 79, at 375-82 (discussing the difference between nominate real contracts, in which the person to whom the property is delivered is bound to give it back, and innominate real contracts, in which the person is bound to give something in return). The literal contract involved entering promises in ledgers that well-to-do citizens customarily kept. *Id.* § 81, at 391-92. Gradually, the literal contract fell into disuse. *Id.* at 395.

15. "*Ius civile*" refers to the "common law" or "general custom of the realm," a body of law not governed by statute. W.W. BUCKLAND, THE MAIN INSTITUTIONS OF ROMAN PRIVATE LAW 14 (1931) [hereinafter ROMAN PRIVATE LAW]; MAX KASER, ROMAN PRIVATE LAW 23-24 (Rolf Dannenbring trans., 1965).

16. SCHULZ, *supra* note 13, at 524-25.

17. LAWSON, *supra* note 11, at 121. For the Romans, like most societies, sale covered a broad range of commercial transactions. *Id.* at 120. Contracts for "hire" in Roman law included not only the leasing of land, buildings, and goods, but also the employer-employee relation, bailments, contracts for transportation of people or goods, contracts to repair goods, contracts to construct buildings or goods (except when the manufacturer supplied all of the raw materials, in which case the transaction was a sale), and some kinds of insurance. *Id.* Partnership included all profit and not-for-profit associations and joint ventures. *Id.* at 121. Mandate included all transactions in which one person gratuitously undertook to do something for another, which in some instances included the agency relationship. *Id.* at 121.

18. SCHULZ, *supra* note 13, at 525.

19. In the classical period, ordinary civil procedure began with a proceeding before a magistrate (proceedings *in iure*); if the magistrate failed to commence an *indicium*, the plaintiff's claim was dismissed. *Id.* at 13. Otherwise, the magistrate "formulated" the action in his court and referred the matter to another tribunal for resolution. BUCKLAND, TEXT-BOOK OF ROMAN LAW, *supra* note 13, at 627. The official document in which the referral was contained was the *formula*. Over time, numerous *formulae* became standardized, and lawyers of the period possessed stockpiles of *formulae*. SCHULZ, *supra* note 13, at 19-20. The *formula*, being an instruction to the tribunal deciding the case, could be modified to state the exact issue for decision, which became a way new actions, defenses, rights, and liabilities could be created. BUCKLAND, TEXT-BOOK OF ROMAN LAW, *supra* note 13, at 627. This procedure was used for about five centuries in the Roman Empire, including the classical period. BURDICK, *supra* note 14, at 636.

20. The cause of action available for a breach of contract was the standard *formulae in ius conceptae*. SCHULZ, *supra* note 13, at 525. A *formula* that was designated *in ius* was one in which

clause *ex fide bona*.<sup>21</sup> The original purpose of the clause *ex fide bona* was to provide an independent source of obligation on which a judgment for breach of contract could be founded.<sup>22</sup> When no longer needed for this purpose, the clause survived to provide a standard by which each of the contracting parties' performances would be measured. Thus, *ex fide bona* authorized the judge to fix the sum that the defendant owed the plaintiff according to standards of good faith.<sup>23</sup> Professor Sohm described sale in this way: "Sale is a *bonae fidei negotium*, i.e. both parties are bound, not merely to do what they expressly undertook to do, but to do all that is involved in the requirements of good faith."<sup>24</sup> The other three kinds of consensual contracts included the same reciprocal good faith obligation.<sup>25</sup> Thus, the principles of *bona fides*, which continually evolved to reflect prevailing moral ideals, were a part of all consensual contracts.<sup>26</sup>

2. *The law of promise after the Roman Empire.*—Although study of Roman law did not entirely perish after the decline of the Roman Empire, it was not until the twelfth century that interest in Roman law was revived on the continent and exerted some influence on the by-then developing law in England.<sup>27</sup> During the intervening centuries, the primitive law of

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"the condemnation of the defendant [was] made conditional upon the plaintiff having a right or claim," the merits of which could be determined solely through the application of law rather than upon proof of the existence of certain facts. *Id.* at 29. In the preparation of a *formula*, the form of the plaintiff's claim (*intentio*) would be either conceived in fact (*in factum concepta*) or conceived in law (*in ius concepta*). BURDICK, *supra* note 14, at 646.

21. SCHULZ, *supra* note 13, at 525. If the clause *ex fide bona* appeared in a *formula*, the proceeding was called a *bonae fidei indicium*, and pursuant to the procedure, the judge was ordered to pronounce judgment in accordance with what good faith required. *Id.* at 35.

22. KASER, *supra* note 15, at 142.

23. LAWSON, *supra* note 11, at 124-25; SCHULZ, *supra* note 13, at 35. Kaser succinctly describes this evolution:

From the beginning of the classical age *bonae fidei indicia* were accepted as part of the *ius civile* because it was thought that good faith was just as binding as a *lex*. The function of *bona fides* changed accordingly; *bona fides* was no longer needed as an independent source of obligation, but it now provided a standard according to which the judge had to examine the legal relationship. The content of the obligation was now taken to comprise all that which had been informally agreed upon by the parties themselves, with regard to the source and content of obligations, but also that which—even failing such agreement—was to be regarded as being owed according to the concrete circumstances and in consideration of the local and general custom.

KASER, *supra* note 15, at 142-43.

24. SOHM, *supra* note 12, § 82, at 396-97.

25. *Id.* § 82, at 405 ("[T]he contract of hire is a *bonae fidei negotium*."); *id.* § 82, at 406-07 (discussing the obligation of good faith in partnership contracts); *id.* § 82, at 407 (noting that the mandate contract "binds both parties to do all that is required by *bona fides*").

26. PETER STEIN, *FAULT IN THE FORMATION OF CONTRACT IN ROMAN LAW AND SCOTS LAW* 6 (1958).

27. 1 FREDERICK POLLOCK & FREDERIC W. MAITLAND, *THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I*, at 1 (reprint 1923) (London, Cambridge Univ. Press, 2d ed. 1898); see PAUL

promise on the continent contained hints of the moralistic good faith standard that the classical Romans had used to measure performance under consensual contracts. For example, the Franks<sup>28</sup> devised a sacramental ceremony for making a promise binding. When one party owed another a debt that could not be secured fully, the debtor made "faith 'with gage and pledge'" in a ritual called *fides facta*.<sup>29</sup> As this ceremony developed, the debtor passed the *festuca*—a stick, and later a piece of straw—from one of his hands to the other, and then to the creditor. By this ceremony of *fides facta*, the debtor bound himself to the creditor;<sup>30</sup> rather than providing animate security to the creditor, the debtor was regarded as "a hostage who is at large but is bound to surrender himself if called upon to do so."<sup>31</sup> In effect, the good faith of the debtor either to perform or to surrender himself secured the creditor's loan.

The ceremony of *fides facta* probably evolved into the ritual of mutual grasp of hands, a method of binding promises found in many early cultures.<sup>32</sup> By the mutual handgrip, "the promisor proffered his hand in the name of himself and for the purpose of devoting himself to the god or the goddess if he broke faith."<sup>33</sup> The resemblance of the mutual handgrip to the Roman ceremony of stipulation, as well as the similarity of the term "*fides facta*" to the phrase "*fidem facere*" used by Romans to describe the

G. VINOGRADOFF, *ROMAN LAW IN MEDIEVAL EUROPE* 97, 97-117 (2d ed. 1929) (arguing that Roman law "exercised a potent influence on the formation of legal doctrines during the critical twelfth and thirteenth centuries, when the foundations of the common law were laid"); 2 WILLIAM S. HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 202-06 (3d ed. 1923) (surveying the ways in which Roman law influenced the development of English common law); cf. PETER STEIN, *Roman Law and English Jurisprudence Yesterday and Today*, in *THE CHARACTER AND INFLUENCE OF THE ROMAN CIVIL LAW* 151, 151-53 (1988) [hereinafter *CHARACTER AND INFLUENCE*] (describing Henry of Bracton's effort in the 13th century to prove that the English common law was coherent and rational by comparing it to the codified Roman civil law). Also, there is evidence that early in the 17th century, English writers began to recognize Roman law's influence upon English law. See PETER STEIN, *Continental Influences on English Legal Thought 1600-1900*, in *CHARACTER AND INFLUENCE*, *supra*, at 209, 212-14 (describing the work of writers who argued that English law coincided to a large degree with Roman law).

28. The Franks were a Germanic tribe that occupied the Rhine Valley from roughly the third to eighth centuries. EDWARD JAMES, *THE FRANKS* 6, 7 (1988).

29. 2 POLLOCK & MAITLAND, *supra* note 27, at 187. A thing given by way of security—what would now be called a "pledge"—was in this period called a "gage." The word "pledge" meant for the Franks that which we would now call a "surety"—a person who guarantees a debt. Gage, then, was security by thing; a pledge was security by person. *Id.* at 185 n.2.

30. *Id.* at 186-88.

31. *Id.* at 187.

32. See 2 *id.* at 187-89 (hypothesizing about the process by which the *fides facta* evolved into the common handshake ritual). This substituted for an earlier version of the ceremony in which the debtor passed the *festuca* to the creditor who handed it to the pledge. This made the pledge the creditor's hostage, while the pledge had power to constrain the debtor to pay the debt. *Id.*

33. *Id.* at 188.



ceremony of *stipulatio*, suggests that *fides facta* was a ceremony borrowed from the Romans.<sup>34</sup>

The development of the simple contract on the continent probably paralleled the development of the formal contract in Anglo-Saxon England. In the earliest time, the Anglo-Saxon contract was probably created by delivering a chattel of little value and furnishing sureties.<sup>35</sup> As on the continent, other ceremonies—such as the handgrasp, the oath, or a simple pledge to perform in “good faith”—would soon serve to substitute for furnishing tangible security.<sup>36</sup> Whatever the original source of the ritual of *fides facta*, “the feudal, or rather the vassalic contract, is a formal contract and its very essence is *fides*, faith, fealty.”<sup>37</sup>

3. *Canon law*.—As these rules evolved, a new body of law was emerging under the auspices of the Christian Church that filled the absence of order after the collapse of the Roman Empire. By the tenth and eleventh centuries, “for the greater part of the Continent . . . ecclesiastical law [was] the only sort of law that [was] visibly growing.”<sup>38</sup> Under the influence of the Church, the ceremony of *fides facta* was transformed into the pledge of faith. In effect, the gage provided by the debtor was the debtor’s Christian faith and his hope of salvation.<sup>39</sup> Usually promisors pledged their faith to ecclesiastics, but it is likely that promisors sometimes pledged their faith to promisees.<sup>40</sup> From this ritual, it was a short step to recognizing a promisor’s “word” or “honor” as sufficient to bind a promise.<sup>41</sup> In effect, then, a person would treat another’s promise as having value only because of the promisor’s pledge that performance would be forthcoming in *fides* or in good faith, which was evidenced by the promisor’s willingness to sacrifice his honor or even his hope of eternal life in the event he should fail to perform. In addition, by the middle of the

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34. *Id.* at 188-89.

35. Harold D. Hazeltine, *The Formal Contract of Early English Law*, 10 COLUM. L. REV. 608, 609 (1910).

36. *Id.*

37. 2 POLLOCK & MAITLAND, *supra* note 27, at 189. Pollock and Maitland consider “feudalism” an “unfortunate word,” because the feudal period, the key characteristic of which was the presence of “dependent and derivative land tenure” arising out of the relationship of lord and vassal, describes conditions in England and the continent from the eighth or ninth to the 14th or 15th centuries. 1 *id.* at 66-67. Regardless, the faith inherent in *fides facta* presumably became the good faith obligation of the feudal contract.

38. *Id.* at 18.

39. 2 *id.* at 190.

40. *Id.* at 191-92.

41. *See id.* at 192 (“And like a man’s religious faith, so his worldly honour can be regarded as an object that is pawned to a creditor.”); THEODORE F. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 630-31 (5th ed. 1956) (observing that the pledge of faith was treated as a material object by medieval society).

twelfth century, the Church had taken over the law of marriage, and it began to teach that binding marriage contracts could be formed by merely exchanging words.<sup>42</sup> Within another century, this notion had spilled over to nonmarriage agreements; exchanged promises were treated as morally binding regardless of whether they were accompanied by security or a pledge of faith.<sup>43</sup>

In canon law, then, the ideal of good faith figured prominently among those identifiable principles against which the behavior of contracting parties was measured. In Holdsworth's view, canon law "put into legal form the religious and moral ideas which, at this period, coloured the economic thought of all the nations of Western Europe," and thus "contributed to enforce those high standards of good faith and fair dealing which are the very life of trade."<sup>44</sup>

Canon law also influenced the law of promises in England. For instance, the ecclesiastical courts in England were willing to enforce simple promises at a time when the common law courts issued writs of prohibition to prevent recourse to these courts.<sup>45</sup> In addition, the first chancellors were ecclesiastics who naturally were trained in canon law.<sup>46</sup> Thus, the basic principles of the ecclesiastical courts were adopted and applied in the Court of Chancery.<sup>47</sup>

4. *Summary.*—Although not a great deal can be said about the status of the development of English law in the eleventh and twelfth centuries,<sup>48</sup> it is clear that Roman law and ecclesiastical law, two closely related legal systems, helped shape English law. As Pollock and Maitland have explained, "in the days of our King Stephen the imperial mother and her papal daughter were fairly good friends. It was hand in hand that they entered England. The history of law in England, and even the history of

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42. 2 POLLOCK & MAITLAND, *supra* note 27, at 195; Charles Donahue, Jr., *The Canon Law on the Formation of Marriage and Social Practice in the Later Middle Ages*, 8 J. OF FAM. HIST. 144, 144 (1983).

43. 2 POLLOCK & MAITLAND, *supra* note 27, at 195.

44. 5 W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 80, 81 (2d ed. 1937), *quoted in* E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 670 (1963) [hereinafter Farnsworth, *Good Faith Performance*].

45. Raphael Powell, *Good Faith in Contracts*, 9 CURRENT LEGAL PROBS. 16, 22 (1956); *see also* Frederick Pollock, *Contracts in Early English Law*, 6 HARV. L. REV. 389, 390 (1893) (noting that ecclesiastical courts competed with secular courts in the field of contract law by censuring breaches of oaths).

46. 2 POLLOCK & MAITLAND, *supra* note 27, at 193.

47. Powell, *supra* note 45, at 22.

48. By the eleventh and twelfth centuries in England, it appears that promises were solemnized by making oaths on faith and delivering a *wed* or *bohr* (basically a material gage). But it is unclear whether the symbolic gage was sufficient to bind a bargain. 2 POLLOCK & MAITLAND, *supra* note 27, at 193.

English law, could not but be influenced by them."<sup>49</sup> It is also clear that the law of promise on the continent after the classical Roman era had similarities to both Roman law and ecclesiastical law. Canon law and Roman law emphasized the moral ingredients of promises, and this orientation no doubt influenced early English law. By the thirteenth century, English law was well on its way to achieving its own independent identity.<sup>50</sup> Nevertheless, as Part I(B) demonstrates, this independent development would be marked periodically by the appearance of the moralistic "good faith" component of promissory liability that had emerged in Roman law, was probably transplanted into the primitive legal systems on the continent at the end of the Roman Empire's reign, and had found its way into canon law.

## B. English Law

1. *Good faith under the writ system.*—Medieval England's common law was a formulary system, the content and structure of which was largely determined by the list of available writs.<sup>51</sup> By the thirteenth century, the King's court was willing to entertain an action of debt in cases where a defendant owed the plaintiff a sum of money.<sup>52</sup> Also, by this time, the King's court would entertain an action in covenant where an obligation was evidenced by a writing under seal and where an action in debt would not lie.<sup>53</sup> These writs were not well suited to providing the basis for a

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49. 1 *id.* at 116-17. This gives a different reading to the work of these historians than does Professor Farnsworth. See Farnsworth, *supra* note 9, at 591 ("[R]oman concepts of contract . . . exercised no significant influence on the common law."). Although "the process of arriving at a general law of contract was different in England and on the continent," 2 POLLOCK & MAITLAND, *supra* note 27, at 195, English scholars and jurists studied and, while not controlled by, were certainly influenced by precepts of Roman and canon law, see PETER STEIN, *Legal Theory and the Reform of Legal Education in Mid-Nineteenth Century England*, in CHARACTER AND INFLUENCE, *supra* note 27, at 231, 243 (noting that Roman law was considered a part of general English jurisprudence in the mid-19th century); 1 POLLOCK & MAITLAND, *supra* note 27, at 135, 117-35 (surveying the influence of Roman and canon law and concluding that "[o]ur English law shows itself strong enough to assimilate foreign ideas and convert them to its own use. Of any wholesale 'reception' of Roman law there is no danger.").

50. See 2 POLLOCK & MAITLAND, *supra* note 27, at 197 ("[B]efore the thirteenth century was out, both Roman and canon law had lost their power to control the development of English temporal law.").

51. See *id.* at 558-73 (discussing the various writs). The available writs were recorded in the "Register," a loose, semi-official compilation of forms. PLUCKNETT, *supra* note 41, at 276-77.

52. See 2 POLLOCK & MAITLAND, *supra* note 27, at 203-16 (tracing the development of the action of debt in the King's court); A.W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT 56-58 (1975) (chronicling the early development of the writ of debt); Farnsworth, *supra* note 9, at 593 (noting that the action in debt had fully evolved by the end of the 12th century).

53. See J.B. Ames, *Parol Contracts Prior to Assumpsit*, 8 HARV. L. REV. 252, 252 (1894) [hereinafter Ames, *Parol Contracts*] (characterizing the action in covenant, which allowed the enforcement of promises made upon sealed instruments, as one of the contractual remedies that existed before the introduction of assumpsit); see also J.B. Ames, *The History of Assumpsit*, 2 HARV. L. REV.

general theory of contract law. The writ of debt required, among other things, that a benefit previously have been conferred on the defendant.<sup>54</sup> The writ of covenant had rigid formality requirements.<sup>55</sup>

By the first part of the seventeenth century, the writ of assumpsit, through a series of extensions that began in the fourteenth century, would become the vehicle for the English law's recognition that liability could be founded upon a promise.<sup>56</sup> Throughout the period, however, both the King's courts and Chancery decided cases with invocations to the standard of good faith. As Professor Powell explains:

Several statutes provided summary remedies in local courts. But these were inadequate, and many addressed petitions to the King, praying that their adversaries might be compelled to perform their contracts. Of course the words used by them vary a good deal; but with ever-increasing monotony the plea is that the debtor has acted 'against good faith and conscience' or the petitioner prays that the debtor shall be compelled to do 'what good faith and conscience require.' Today, if you produce a will with a normal attestation clause, you will usually get probate of the will in common form without going to court. In the fifteenth century, in a similar way, the use of the words 'good faith and conscience' was probably necessary, not only to catch the eye of the Chancellor but also to put in his hands the key with which he could without qualms open his court to the petitioner. When the Chancellor dealt with the petition, he in turn emphasised the duties of good faith and conscience—especially conscience.<sup>57</sup>

2. *Good faith after the triumph of assumpsit.*—In the century and a half after the triumph of assumpsit, the term "consideration" developed into a test to measure whether facts existed to make a promise enforceable under a writ of assumpsit. Accordingly, much of the history of contract law during this period involves the history of the evolution of the consideration doctrine.<sup>58</sup> During this period, however, some English

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53, 56-57 (1888) [hereinafter Ames, *Assumpsit*] (noting that before the 15th century, an action in covenant generally would not lie if an action in debt was available).

54. See Ames, *Assumpsit*, *supra* note 53, at 55 ("A single contract debt . . . was originally conceived of, not as a contract, in the modern sense of the term, that is, as a promise, but as a grant.").

55. See SIMPSON, *supra* note 52, at 22-25 (outlining the formal requirements of an action in covenant).

56. See J.H. BAKER & S.F.C. MILSOM, *SOURCES OF ENGLISH LEGAL HISTORY: PRIVATE LAW TO 1750*, at 482-505 (1986) (collecting cases, reports, and dialogues illustrating that liability can be based on a promise).

57. Powell, *supra* note 45, at 22.

58. See BAKER & MILSOM, *supra* note 56, at 482, 505 (collecting 16th-century legal cases and commentary that illustrate the development of the consideration doctrine in English law). See generally

thinkers began to express opinions on the relationship between commercial transactions and morality. These early writers typically stressed individualism and emphasized the importance of the individual's conscience in setting fair prices.<sup>59</sup> These views were later refined and expanded in the eighteenth century by David Hume and Adam Smith, each of whom, when arguing that enlightened self-interest would prevent humankind from degenerating into an anarchic state of nature, claimed that self-interest would cause men to honor their promises more regularly as the number of their promises increased.<sup>60</sup> In Professor Atiyah's words, both Smith and Hume "seem to have seen enlightened self-interest as lying at the root, not merely of the legal obligation to perform contracts, but also of the moral obligation to observe promises."<sup>61</sup> To Smith and Hume, a virtual promise to conduct oneself in good faith was implied in any promise, as Professor Atiyah explains:

If it is enlightened self-interest which lies at the root of [promissory or contractual] obligations, it is because promises and contracts invite trust, involve reliance and dependence by others on the word of the promisor. It is not, it seems, any inherent quality possessed by a promise, nor is it because promises are expressions of the will.

. . . [T]o Adam Smith, it was the obligation not to disappoint dependence or expectations which was the source of promissory obligation.<sup>62</sup>

Consistent with this conception of the moral underpinnings of a promise, many contract disputes in this period were decided with reference to principles of fairness. Most contract litigation took place in Chancery, and "in and around 1770 it was . . . the established tradition in Chancery that a contract must basically be fair; or perhaps, to be strictly accurate, that a grossly unfair contract was liable to be upset."<sup>63</sup>

During the eighteenth century, it appeared that good faith might blossom into a broad principle of overarching significance in contract law.

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W.S. Holdsworth, *The Modern History of the Doctrine of Consideration*, 2 B.U. L. REV. 87, 174 (1922) (discussing the "difficulties [that] have arisen in the process of translating" the requirements of assent into the new concept of consideration).

59. See P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 72-73 (1979) (discussing the writing of Thomas Wilson, Richard Steele, Sir Dudley North, Sir Josiah Child, and Sir William Petty).

60. DAVID HUME, *A TREATISE ON HUMAN NATURE* 479-80, bk. III, pt. II, § 1 (L.A. Selby-Bigge ed., Clarendon Press 1980) (1739-40); ADAM SMITH, *LECTURES ON JURISPRUDENCE* 538-39 (R.L. Meek et al. eds., 1978) (1766).

61. ATIYAH, *supra* note 59, at 81.

62. *Id.* at 82-83. See SMITH, *supra* note 60, at 92-95 (arguing that promises should be enforced when a party depends on a promise and reasonably expects its performance).

63. ATIYAH, *supra* note 59, at 147; see *id.* at 173 (noting that the court of chancery would set aside unfair bargains).

Under the influence of Lord Mansfield, contract law briefly flirted with the notion that a consideration was merely a moral obligation, or a mere motive or feeling that one was morally obligated.<sup>64</sup> Lord Mansfield's view of the duty of good faith insofar as it pertained to contract performance was well illustrated by his opinion in *Carter v. Boehm*.<sup>65</sup> In *Carter*, an action on an insurance policy in which the insurer set up the defense of concealment, Lord Mansfield grounded his decision on an obligation of good faith: "The governing principle is applicable to all contracts and dealings. Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary."<sup>66</sup> If Lord Mansfield's view had been adopted, the doctrine of consideration would probably have become one of several ways of evidencing a promise, rather than a substantive prerequisite to a promise's enforcement.<sup>67</sup> Lord Mansfield's efforts to infuse the common law with these equitable notions ultimately failed,<sup>68</sup> but to this day the rules for validating a promise still acknowledge special categories

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64. In *Trueman v. Fenton*, the court held that a promise by a bankrupt to pay a creditor was enforceable even though nothing was exchanged at the time of the promise. *Trueman v. Fenton*, 2 Cowp. 544, 98 Eng. Rep. 1232 (K.B. 1777). This case was consistent with existing precedents that an old debt could be a sufficient consideration for a subsequent promise. See SIMPSON, *supra* note 52, at 456, 457 (explaining 16th century England's gradual recognition of contracts supported by past consideration as an early example of courts enforcing promises that the parties "ought to" perform). However, Lord Mansfield purported to rest the decision on a different ground, one that approaches the theory that consideration was nothing more than a moral duty to do an act:

A bankrupt may undoubtedly contract new debts; therefore, if there is an objection to his reviving an old debt by a new promise, it must be founded upon the ground of its being nudum pactum. As to that, all the debts of a bankrupt are due in conscience, notwithstanding he has obtained his certificate; and there is no honest man who does not discharge them, if he afterwards has it in his power to do so. Though all legal remedy may be gone, the debts are clearly not extinguished in conscience.

*Trueman*, 2 Cowp. at 548, 98 Eng. Rep. at 1234.

65. 3 Burr. 1907, 1910, 97 Eng. Rep. 1162, 1164 (K.B. 1766), discussed in ATIYAH, *supra* note 59, at 168.

66. *Id.* at 1910, 97 Eng. Rep. at 1164.

67. See 8 Holdsworth, *supra* note 44, at 25, 25-30 (tracing the development of Lord Mansfield's views and arguing that if they had been adopted, they would "have fundamentally altered the whole theory of our law of contract").

68. The fatal blow to Lord Mansfield's vision of moral obligation serving as the prerequisite for enforcing a promise was probably dealt in *Rann v. Hughes*, 4 Brown 27, 2 Eng. Rep. 18 (H.L. 1778). In that case, the court expressly rejected the conclusion, announced by Lord Mansfield in *Pillans v. Van Mierop*, 3 Burr. 1663, 1671, 97 Eng. Rep. 1035, 1039 (K.B. 1765), that a lack of consideration would not render a promise unenforceable if the promise was reduced to writing so as to satisfy the Statute of Frauds. *Rann*, 4 Brown at 30-31, 2 Eng. Rep. at 21. The court also rejected the argument that a promise enforceable only in conscience without some consideration of fact is binding. *Id.* In the 20th century, promissory estoppel, or reliance-based obligation—which has some connections to good faith—has emerged as a substantive alternative to consideration. See JOHN S. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* 283, 272-92 (3d ed. 1987) (discussing situations in which courts will accept promissory estoppel "as a substitute for consideration").

where promises are enforceable without either consideration or reliance.<sup>69</sup> The consideration requirement ultimately evolved into a technical, substantive doctrine by which a promise is validated, but as applied, the doctrine was tempered to benefit those who performed in good faith and to restrain those who sought to secure unfair advantages in bad faith.<sup>70</sup>

3. *Good faith in the era of classical economics.*—The classical economic era, which began in the late eighteenth century and continued through the nineteenth century, is often identified with the doctrine of *caveat emptor*, a doctrine that is frequently taken as evidence that courts were not interested in the fairness of contracts.<sup>71</sup> This is somewhat ironic: as noted earlier, Adam Smith, whose work *The Wealth of Nations* is often credited with opening the classical period, very nearly recognized explicitly the duty of good faith and fair dealing in every contract.<sup>72</sup> Professor Atiyah, in his important work on the history of contract law after 1770, concludes that the law never abandoned the moral ideals of fairness in contractual relationships:

The truth is . . . that the early nineteenth century saw little more than a brief flirtation with the doctrine *caveat emptor*; from the beginning this flirtation had to contend with serious opposition from judges who still believed that it was part of the job of the Courts to see that contracts were fair; and by the 1860s, at least in contracts of sale of goods, these judges had won out, and the flirtation was over. The common law had, in large part, returned to the traditions of eighteenth-century Equity when the fairness of a contractual exchange was still an all-important part of contract law.<sup>73</sup>

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69. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 82 (1979) (describing when a promise to pay past indebtedness may be binding); *id.* § 83 (describing when a promise to pay indebtedness discharged in bankruptcy may be binding); *id.* § 84 (describing when a promise to perform a duty despite non-occurrence of a condition may be binding); *id.* § 86 (describing when a subsequent promise for a benefit already received may be binding); *id.* § 88 (describing when a promise to be a surety may be binding).

70. Atiyah discusses the use of the consideration doctrine in the 17th and 18th centuries: What we know of moral beliefs and principles . . . suggests that the fairness of exchange would normally have been an important consideration to lawyers, and this was still a time when the law of contract was being profoundly influenced by moral ideals. The doctrine of consideration itself was a reflection of moral ideal, not of some amoral commercial practices.

ATTYAH, *supra* note 59, at 147; see SIMPSON, *supra* note 52, at 485-88 ("[T]he doctrine of consideration is indeed intensely moralistic, and we may disagree with some of its judgments; what is mistaken is to fail to see that a good law of contract has as its function in relation to the commercial world the imposition of decent moral standards.").

71. ATTYAH, *supra* note 59, at 178-79.

72. See *supra* notes 61-62 and accompanying text.

73. ATTYAH, *supra* note 59, at 479.

### C. American Law

1. *Early uses of good faith.*—The concept of good faith entered American common law in roughly the same mold in which it appeared in English common law in the late eighteenth century. American courts embraced the doctrine of *caveat emptor* with more enthusiasm than their English counterparts,<sup>74</sup> but the moralistic notion that contracting parties owe good faith duties to each other never disappeared from American decisions.

It appears that most late nineteenth-century treatises on contract law, whose writers were presumably familiar with a century of precedents, did not emphasize the principle that a party to a contract must perform in good faith. Instead, these writers, if they mentioned good faith at all, usually discussed the unfairness of fraud, which they were inclined to equate with a lack of good faith.<sup>75</sup> While these writers might be read as evidence that good faith was relegated to a lesser status during the classical economic era, other writers during this period articulated a more broadly based duty of good faith in terms that could as easily have been written a century later. Perhaps the most explicit recognition of the duty appears in the 1878 treatise *Bishop on Contracts*:

When parties enter into a contract in terms, the law presumes each of them to be acting in good faith toward the other; and it binds each to the other, to whatever good faith requires. The implication may be derived from the words employed, from the acts of the parties

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74. *Id.* at 180; see also MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860*, at 180 (1977) (discussing the foundation in English common law doctrine of *caveat emptor* and its subsequent adoption in American courts).

75. The discussion in William Story's treatise provides an example:

No agreement although it be apparently fair, and in compliance with the formalities of law, can be enforced, if it be essentially unfair, and fraudulent. . . . And unless it be made in good faith, and free from the stain of fraud and imposition, it will be spurned from the threshold of every legal tribunal.

WILLIAM W. STORY, *A TREATISE ON THE LAW OF CONTRACTS* 596 (Boston, Little, Brown and Co., 4th ed. 1856). For additional examples, see CHARLES F. BEACH, *A TREATISE ON THE MODERN LAW OF CONTRACTS* 1784-85 (Indianapolis & Kansas City, The Bowen-Merrill Co. 1896) ("[I]f the contract was free from any fraud or bad faith, and was otherwise fair and reasonable, except that what the infant paid was in excess of the value of what he received, he can only recover such excess."); 1 WILLIAM F. ELLIOTT, *COMMENTARIES ON THE LAW OF CONTRACTS* §70, at 98 (1913) ("Fraud as to material matter will vitiate, or render voidable any contract, for good faith is to this extent, at least, one of the essential elements of an agreement." (footnotes omitted)); 2 FRANCIS WHARTON, *A COMMENTARY ON THE LAW OF CONTRACTS* § 654 (Philadelphia, Kay and Brother 1882) ("If a contract is open to two probable constructions, one of which would impute fraud or illegal purpose to one of the parties, while the other construction would be free from such taint, the latter construction will be adopted."). See also LOUIS L. HAMMON, *THE GENERAL PRINCIPLES OF THE LAW OF CONTRACT* § 397, at 792 (1902) ("[I]n case a contract is susceptible of two constructions, the court will so construe it as to make it just and reasonable as between the parties, if that course can be taken without violating the evident intention of the parties, or infringing upon rules of law.").



viewed in connection with the thing contracted about, or from the nature of the transaction.<sup>76</sup>

At the turn of the twentieth century, reported decisions regularly referred to good faith as one of the implied obligations of the parties to a contract.<sup>77</sup> Exemplary of these early decisions is *Industrial & General Trust v. Tod*,<sup>78</sup> in which the New York Court of Appeals held that a railroad reorganization commission's delegated authority to construe the reorganization agreement was not unlimited:

No one can be made by contract the final judge of his own acts, for the law writes "good faith" into such agreements. No covenant of immunity can be drawn that will protect a person who acts in bad faith, because such a stipulation is against public policy, and the courts will not enforce it. The law requires the exercise of good faith, and, no matter how strong the provision to shield from liability may be, there is no protection unless good faith is observed.<sup>79</sup>

In cases where one party's duty to perform was conditioned on that party's satisfaction with the other party's earlier rendered performance, courts held that a refusal to accept the performance must be based on a good faith

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76. JOEL P. BISHOP, BISHOP ON CONTRACTS § 106, at 37-38 (St. Louis, F.H. Thomas & Co. 1878). Similar principles were articulated in another late-19th century treatise:

[T]he law, in order to promote good faith and make men act up to the spirit as well as to the letter of their engagements, will create and supply, as a necessary result and consequence of the contract, certain covenants and obligations, which bind the parties as forcibly and effectually as if they had been expressed in the strongest and most explicit terms in the deed itself.

3 CHARLES G. ADDISON, A TREATISE ON THE LAW OF CONTRACT ¶ 1400, at 492 (Jersey City, Fred. D. Linn & Co., James A. Morgan ed. 1883).

77. See, e.g., *Chicago Mun. Gas-Light & Fuel Co. v. Town of Lake*, 22 N.E. 616, 619 (Ill. 1889) (discussing the principle that where a party seeks specific performance, the complainant must show that the "contract has been fully and fairly, in good faith, performed"); *Ruggles v. Merritt*, 132 N.W. 112, 114 (Mich. 1911) (finding that the duty of legal representatives is to fulfill their contractual obligations "in good faith"); *Crouch v. Gutman*, 31 N.E. 271, 273 (N.Y. 1892) (finding that as a condition of substantial completion of the contract despite defects in performance, the "builder must in good faith [have] intended to comply with the contract"); *Armstrong v. Agricultural Ins. Co.*, 29 N.E. 991, 992 (N.Y. 1892) (requiring of an insurer "entire good faith and fair dealing in its transactions" with the insured when the insured is obligated to provide proof of loss); *Duryea v. Bliven*, 25 N.E. 908, 908-09 (N.Y. 1890) (explaining, with respect to settlement agreement following divorce, "[a] contract of this character is incapable of the exact performance which may be made of a business one, but, nevertheless, both parties are required to attempt to carry it out in good faith"); *Serfass v. Driesbach*, 21 A. 523, 524 (Pa. 1891) (stating that before plaintiffs can recover on the contract, they must prove that they "had performed, in good faith, substantially, all the covenants and stipulations contained in this contract"); *Bond v. Terrell Cotton & Woolen Mfg. Co.*, 82 Tex. 309, 311-12, 18 S.W. 691, 692 (1891) (stating that if a party has received from a corporation the benefit of "a contract fully performed in good faith by it," then that party must discharge its obligations under the contract).

78. 73 N.E. 7 (N.Y. 1905).

79. *Id.* at 9.

objection.<sup>80</sup> As one court explained, "if A. agrees to make something for B., to meet the Approval of B. . . . , B. may reject it for any objection which is made in good faith, and is not merely capricious."<sup>81</sup> Other cases announced the general principle that every contract contains an implied duty of good faith and fair dealing between the parties.<sup>82</sup> Typical of these cases is *Brassil v. Maryland Casualty Co.*,<sup>83</sup> in which the New York Court of Appeals held that the insured could recover from the insurer his expenses of prosecuting an appeal that the insurer had refused to take from an adverse judgment against the insured:

[I]t is enough to say that it would be a reproach to the law if there were no remedy for so obvious a wrong as was inflicted upon this plaintiff. His rights . . . go deeper than the mere surface of the contract written for him by the defendant. Its stipulations imposed obligations based upon those principles of fair dealing which enter into every contract. Even defendant has invoked [in its answer] this implied obligation of good faith and fair dealing not expressed in the written terms of its written contract. . . . If [it were the plaintiff's duty to deal fairly and in good faith with the defendant,] it was not less the correlative obligation of the defendant to "deal fairly and in good faith" with him.<sup>84</sup>

Despite considerable support for the existence of a duty of good faith contract performance in the early twentieth century, the American Law Institute, which undertook to draft the *Restatement (First) of Contracts* in

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80. See, e.g., *Doll v. Noble*, 22 N.E. 406, 407 (N.Y. 1889) (holding that the defendant could not defeat recovery under a contract providing for work to be done in the best workmanlike manner by asserting in bad faith that the work was not done to his satisfaction); *Baltimore & O.R. Co. v. Brydon*, 3 A. 306, 309-10 (Md. 1886) (holding that a purchaser must exercise good faith in refusing the delivery of coal when under the contract, the purchaser could refuse coal that it deemed unsatisfactory); *Singerly v. Thayer*, 2 A. 230, 233 (Pa. 1885) (holding that a refusal to accept an elevator on the ground that it was not satisfactory must be made in good faith and must not be capricious); *Thomas v. Fleury*, 26 N.Y. 26, 34 (1862) (holding that although a building contract made an architect's certificate a condition precedent to payment, the builder could recover when the architect in bad faith refused the certificate).

81. *Singerly*, 2 A. at 233.

82. See, e.g., *Ratzlaff v. Trainor-Desmond Co.*, 183 P. 269, 271 (Cal. Dist. Ct. App. 1919) (holding that a seller of land may not in bad faith seek a cancellation of a sale contract in order to frustrate the payment of a commission to the sale broker); *People ex rel. Wells & Newton Co. v. Craig*, 133 N.E. 419, 426 (N.Y. 1921) (implying a good faith obligation to allow a timely opportunity to complete a contracted job); *Wigand v. Bachmann-Bechtel Brewing Co.*, 118 N.E. 618, 619 (N.Y. 1918) (implying a good faith duty not to shut down operations in order to avoid the obligation of an output contract); *Simon v. Etgen*, 107 N.E. 1066, 1067 (N.Y. 1915) (implying a good faith duty to sell a building when the proceeds from the sale were obligated to be paid as part of a settlement agreement); *Hilleary v. Skookum Root Hair-Grower Co.*, 23 N.Y.S. 1016, 1018 (Com. Pl. 1893) (holding that ambiguous language in a personal services contract must be resolved in a manner implying good faith by both parties).

83. 104 N.E. 622 (N.Y. 1914).

84. *Id.* at 624.

the 1920s, did not give explicit recognition to an implied duty of good faith and fair dealing.<sup>85</sup> Indeed, the *Restatement (First)* made no mention of it. But this did not lessen the principle's acceptance. A 1933 New York Court of Appeals decision, *Kirke La Shelle Co. v. Paul Armstrong Co.*,<sup>86</sup> articulated the duty in this way:

[I]n every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.<sup>87</sup>

2. *Developing a unified theory of good faith.*—By the mid-twentieth century, some commentators began to realize that a common thread linked the various settings in which courts resorted to the principle of good faith to dispose of cases, and it was in this period that the first efforts to state a unified theory of good faith performance emerged. Somewhat fortuitously, the doctrine of good faith performance appeared in the first drafts of the Uniform Commercial Code.<sup>88</sup> Section 1-203 of the 1952 official draft provided that “[e]very contract within this Act imposes an obligation of good faith in its performance or enforcement,”<sup>89</sup> and thirteen other sections in Article 2 explicitly required good faith in transactions for the sale of goods.<sup>90</sup>

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85. RESTATEMENT (FIRST) OF CONTRACTS (1932); see RESTATEMENT (SECOND) OF CONTRACTS § 231 reporter's note (Tentative Draft No. 5, 1970) (noting that the Draft included a duty of good faith and fair dealing in the *Restatement* for the first time).

86. 188 N.E. 163 (N.Y. 1933).

87. *Id.* at 167.

88. Section 242 of the German Civil Code, one of the most famous and important of all pronouncements on good faith, is important to this history. The Section is a simple, one-sentence statement: “The debtor is bound to effect performance according to the requirements of good faith, giving consideration to common usage.” THE GERMAN CIVIL CODE § 242 (Ian S. Forrester et al. trans., 1975). It is now recognized “as a statutory enactment of a general requirement of good faith, a ‘principle of legal ethics,’ which dominates the entire [German] legal system.” NORBERT HORN ET AL., GERMAN PRIVATE AND COMMERCIAL LAW: AN INTRODUCTION 135 (Tony Weir trans., 1982). Professor Karl Llewellyn was the Chief Reporter for the Uniform Commercial Code, and he was very familiar with § 242. Thus, it is fair to say that the good faith principle that appeared in § 1-203 had its strongest roots in good faith's civil law heritage. See John P. Dawson, *Unconscionable Coercion: The German Vision*, 89 HARV. L. REV. 1041, 1044 (1976) (noting that U.C.C. § 1-203 is the “twin sister” of § 242 of the German Civil Code). This suggests another observation: To the extent good faith in the Anglo-American tradition and good faith in the civil law share Roman law's notions of good faith as common ancestry, the twentieth-century connection between § 1-203 and the civil law arguably marks a return to common ground.

89. U.C.C. § 1-203 (Official Draft 1952).

90. *Id.* §§ 2-103, 2-306, 2-325, 2-328, 2-401, 2-402, 2-403, 2-506, 2-603, 2-615, 2-702, 2-706, 2-712.

The drafters of the Code conceived of good faith as an aspect of bona fide purchase,<sup>91</sup> a doctrine in which good faith is used to describe the state of mind of a buyer; in this context, good faith refers to whether the buyer took goods without notice, knowledge, or suspicion of an irregularity in the transaction.<sup>92</sup> The broader legal significance of good faith as a standard for performance or enforcement of a contract was noticed in the mid-1960s, when commentators began to discuss the significance of the duty of good faith implied in every contract for the sale of goods. In 1963, Professor Farnsworth published a brief article on the relationship and origins of the good faith purchase and good faith performance requirements of the Uniform Commercial Code.<sup>93</sup> Professor Summers followed in 1968 with an important article on the duty of good faith, both in general contract law and under the Code.<sup>94</sup>

Courts continued to refer to good faith and fair dealing in contract performance,<sup>95</sup> and by 1970, the American Law Institute's tentative draft of the *Restatement (Second) of Contracts* contained a section on good faith and fair dealing.<sup>96</sup> This section ultimately became Section 205 in the official *Restatement*, which was adopted in May 1979.<sup>97</sup> Section 205 provides that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."<sup>98</sup> Section 205 includes a comment titled "Meanings of 'good faith,'" but the comment provides no precise statement of the substantive content of the duty.<sup>99</sup>

91. Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 208 & n.53 (1968).

92. See Farnsworth, *Good Faith Performance*, *supra* note 44, at 668 (noting that under the "good faith purchase" provisions of the U.C.C., a "party is advantaged only if he acted with innocent ignorance or lack of suspicion").

93. Farnsworth, *Good Faith Performance*, *supra* note 44 (tracing the development of good faith purchase and good faith performance and arguing that courts should interpret good faith provisions of the U.C.C. under an objective standard of commercial reasonableness).

94. Summers, *supra* note 91, at 196 (arguing that good faith performance is a phrase that has no meaning of its own, "but which serves to exclude many heterogeneous forms of bad faith").

95. See, e.g., *Ventura v. Colgrove*, 75 Cal. Rptr. 495, 498 (Ct. App. 1969) ("[I]mplied covenants within said alleged contract . . . of fair dealings and good faith did create a duty of express disclosure."); *Colwell Co. v. Hubert*, 56 Cal. Rptr. 753, 759 (Ct. App. 1967) ("[I]n every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing."); *Jos. H. Carter, Inc. v. Carter*, 127 N.Y.S.2d 518 (Sup. Ct. 1953) (referring to a defendant's obligation "to faithfully and in good faith and fair dealing perform and discharge his obligations and duties under the contract"), *aff'd*, 129 N.Y.S.2d 898 (App. Div. 1954); *Ekstrom v. Wisconsin*, 172 N.W.2d 660, 661 (Wis. 1969) ("Every contract implies good faith and fair dealing between the parties to it, and a duty of co-operation on the part of both parties." (quoting 17 AM. JUR. 2D *Contracts* § 256, at 653 (1964))).

96. RESTATEMENT (SECOND) OF CONTRACTS § 231 (Tentative Draft No. 5, 1970).

97. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

98. *Id.*

99. *Id.*

The comment repeats the definitions of good faith found in the Uniform Commercial Code,<sup>100</sup> stopping short of offering these definitions as dispositive. The comment proceeds:

The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances.<sup>101</sup>

Improving upon the foregoing conceptualization of good faith is difficult. Some commentators have criticized the vagueness of the good faith standard,<sup>102</sup> a perhaps inevitable development in light of the near tautological qualities of any definition of good faith. Professor Summers, whose writings on the subject of the duty of good faith were highly influential in the drafting of Section 205, believes that stating a unified positive meaning of good faith is unnecessary and probably futile.<sup>103</sup> Instead, Professor Summers recommends conceptualizing good faith as an "excluder" by contrasting good faith with the kinds of bad faith that are ruled out in particular settings.<sup>104</sup> This approach, he argues, is adequate to make the principle of good faith useful in the very sense that rules of law are useful.<sup>105</sup>

Concerned that courts may "overextend" the meaning of good faith, thereby disrupting the predictability and certainty of commercial dealings, and that the absence of a unified conceptualization of good faith will mean

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100. *Id.* cmt. a (quoting U.C.C. § 1-201(19) (1991) ("Good faith is defined . . . as 'honesty in fact in the conduct or transaction concerned.'"); *id.* § 2-103(1)(b) ("'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.")).

101. *Id.*

102. See, e.g., Clayton P. Gillette, *Limitations on the Obligation of Good Faith*, 1981 DUKE L.J. 619, 642-47 (arguing that the vagueness inherent in the term "good faith" results in disagreements over its requirements and interferes with the performance of contracts); cf. Patricia K. Gillette, *The Implied Covenant of Good Faith and Fair Dealing: Are Employers the Insurers of the Eighties?*, 11 EMPLOYEE REL. L.J. 438, 449-50 (1985-86) (discussing the problems in determining standards for the breach of the implied covenant of good faith and fair dealing in the employment context); Patricia A. Milon, *Recent Development, Implied Covenants of Good Faith and Fair Dealing: Loose Cannons of Liability for Financial Institutions?*, 40 VAND. L. REV. 1197, 1230-31 (1987) (noting the ambiguity of the covenant of good faith and fair dealing as applied to financial institutions).

103. Summers, *supra* note 90, at 206.

104. *Id.* at 201-02. Note that the word "excludes" is contained in the RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1979).

105. Summers, *supra* note 90, at 264-65.

that the conduct of almost any party to almost any contract may be vulnerable to claims of bad faith, Professor Burton has conceptualized good faith from a "cost perspective," reasoning that the "good faith performance doctrine . . . directs attention to the opportunities forgone by a discretion-exercising party at [contract] formation, and to that party's reasons for exercising discretion during performance."<sup>106</sup>

However one assesses this debate<sup>107</sup> and the perspectives of other commentators,<sup>108</sup> the fact remains that the duty of good faith and fair dealing has ancient lineage. Reading this history from the most skeptical of perspectives, one could assert that during a relatively brief period in the eighteenth and nineteenth centuries the duty was relegated a lesser role in commercial dealings, but even such a skeptic would have to admit that the twentieth century has witnessed a revival that rediscovers the doctrine's historical roots.

## II. Bad Faith and Insurance

By the early 1980s, many courts had concluded that an insurer's breach of the duty to defend, the duty to settle, or the duty to pay proceeds constituted bad faith, and that this bad faith performance of the contract constituted a tort.<sup>109</sup>

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106. Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 372-73 (1980). Professor Burton argues that:

[b]ad faith performance occurs precisely when discretion is used to recapture opportunities forgone upon contracting—when the discretion-exercising party refuses to pay the expected cost of performance. Good faith performance, in turn, occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation—to capture opportunities that were preserved upon entering the contract, interpreted objectively.

*Id.* at 373.

107. See Steven J. Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1, 5-6 (1981) (suggesting an approach to good faith that focuses on the discretion-exercising party's motivations and the dependent party's expectations); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 818-21 (1982) (arguing that good faith can be defined only by a nonexclusive list of what it does not mean); Steven J. Burton, *More in Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 500 (1984) (defining good faith as the situation in which the party with discretion exercises it only to capture alternative opportunities that were preserved at the time of contracting).

108. See Eric G. Andersen, *Good Faith in the Enforcement of Contracts*, 73 IOWA L. REV. 299, 324-25 (1988) (arguing that good faith depends on the effects of a party's acts in performance, not the motivations behind them); H. Walter Croskey, *Bad Faith in California: Its History, Development and Current Status*, 26 TORT & INS. L.J. 561, 573-80 (1991) (citing reasonableness as a key component of good faith and listing over 20 specific duties imposed on insurers by the common law implied covenant of good faith); Michael H. Cohen, Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CAL. L. REV. 1291, 1302 (1985) (defining bad faith as the obstruction of the other party's interest in receiving compensation for a breach).

109. See, e.g., *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 873-79 (Ariz. 1981) (recognizing and defining the tort of bad faith refusal to pay proceeds); *Conunale v. Traders & Gen.*

The rationales of these decisions vary greatly, but the common theme is that insurance policies are different from ordinary commercial contracts, and contractual remedies are inadequate in this setting to balance the interests of insurer and insured fairly.<sup>110</sup> Unfortunately, just as today we lack data to assess the extent to which the tort of bad faith has skewed ratemaking, underwriting, claims processing, and defense and settlement of third-party claims,<sup>111</sup> in the early 1980s no one had data clearly demonstrating contract law's inability to deter insurer misconduct and fairly compensate aggrieved insureds. In other words, the orienteer, before merrily marching on her way, did not take the time to read the compass carefully, and many followed her.

Hindsight has its benefits, and from the perspective of the wrong side of the mountain, it is easy to understand how we arrived at our current location, even if we do not know where to go. In many respects, the potential of contract law to respond to insurer overreaching was simply not understood, and the choice was made to remedy insurers' bad faith breaches in tort. Having heard it argued in the halls of academia that contract law cannot deter insurers' bad faith breaches or compensate insureds adequately because it has no mechanism for giving an excess judgment when the insurer has breached the duty to defend or the duty to settle,<sup>112</sup> I suspect this same argument has been made before trial courts,

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Ins. Co., 328 P.2d 198 (Cal. 1958) (holding that breaches of the duty to defend and the duty to settle are two distinct torts even when committed simultaneously); *Zumwalt v. Utilities Ins. Co.*, 228 S.W.2d 750, 753-55 (Mo. 1950) (distinguishing between the negligent refusal to settle, for which the insurer cannot be held liable beyond the policy limits, and the bad faith refusal to settle, for which it can); *Smith v. American Family Mut. Ins. Co.*, 294 N.W.2d 751, 755-56 (N.D. 1980) (recognizing the refusal to defend as a tort); *Santilli v. State Farm Life Ins. Co.*, 562 P.2d 965, 969 (Or. 1977) (referring to the tort of an insurer's bad faith refusal to settle within the coverage limits); *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368, 373-79 (Wis. 1978) (recognizing and defining the tort of bad faith refusal to pay proceeds).

110. See, e.g., *Hiatt v. Schreiber*, 599 F. Supp. 1142, 1145 (D. Colo. 1984) ("[A]n insurance policy between an insured and a vendor requires different remedies [than standard contract remedies]."); *Rodgers v. Pennsylvania Life Ins. Co.*, 539 F. Supp. 879, 883 (S.D. Iowa 1982) ("The superior bargaining power of an insurance company over its insured has long been recognized in Iowa."); *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 867 (Ariz. 1981) ("The special nature of an insurance contract has been recognized by courts and legislatures for many years."); *Crisci v. Security Ins. Co.*, 426 P.2d 173, 179 (Cal. 1967) ("Plaintiff did not seek by the contract involved here to obtain a commercial advantage but to protect herself against the risks of accidental losses."); *Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co.*, 375 A.2d 428, 430 (Conn. Super. Ct. 1977) ("[T]he unequal bargaining power of the parties, the special nature of the insurance business, and the disastrous economic effects that a bad faith refusal to pay may cause the insured are paramount considerations."); *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 318 (R.I. 1980) ("Recovery under a contract theory alone . . . effectively guards an insurer's pocketbook against any threat of punitive damages.").

111. See Abraham, *supra* note 1, at 1313 (noting an absence of quantitative analysis of the cost to insurers of paying claims of marginal quality merely to avoid allegations of bad faith).

112. The former colleague, a professor of torts, who made this argument shall be allowed to remain anonymous.

the trenches where the wars are fought. The argument, of course, is wrong. Contract law, in addition to giving damages for loss of the bargain<sup>113</sup> (in this case, the insurer's promise to pay proceeds), awards consequential damages in appropriate cases.<sup>114</sup> The excess judgment that results from an insurer's failure to defend or settle a claim in circumstances in which it should do so is a natural, foreseeable consequence of the breach—in other words, precisely the kind of loss for which contract law gives a remedy. But we cannot know easily to what extent this basic point was forgotten by the trial courts that assembled the records that were later reviewed on appeal by courts that substituted a different rationale but nevertheless sustained the lower courts' rejection of the contract paradigm.

Unlike the duty to defend, the duty to settle is not stated in so many words in the typical liability insurance policy.<sup>115</sup> Moreover, the insurer is not obligated to settle every claim within coverage but is obligated to act reasonably in response to settlement offers.<sup>116</sup> To differentiate between reasonable and unreasonable insurer conduct, one must have a standard, and courts often and understandably used phrases such as "due care," "negligence," "good faith," or "reasonableness" to demarcate proper and improper responses to a settlement offer in the context of a particular case.<sup>117</sup> Each of these phrases sounds as if the tort paradigm is being invoked, and it is only a small step to the conclusion that the insurer's negligence, failure to use due care, unreasonable behavior, or bad faith must be a tort. But this presumes that the duty to settle is a tort duty, when it makes just as much sense to treat the duty to settle as a sub-duty of the broader duty to defend, under the reasoning that responding to or making settlement offers is one aspect of carrying out the contractually based duty to defend.<sup>118</sup>

Because the duty to settle does not appear in explicit language in the typical liability policy, it was easy to assert that the duty to settle must be

113. E. ALLAN FARNSWORTH, *CONTRACTS* § 12.9, at 879 (2d ed. 1990).

114. *Id.* § 12.9, at 880.

115. Compare ROBERT H. JERRY, II, *UNDERSTANDING INSURANCE LAW* § 111[a] (1987) ("The duty to defend is a contractual obligation arising out of the language of the policy itself.") with *id.* § 112 ("The typical liability insurance policy has no language requiring the insurer to settle a lawsuit brought against the insured.").

116. *Id.* § 112.

117. See, e.g., *Bollinger v. Nuss*, 449 P.2d 502, 508 (Kan. 1969) (good faith); *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 157 A.2d 319, 322 (N.J. 1960) (good faith); *Trotter v. State Farm Mut. Auto. Ins. Co.*, 377 S.E.2d 343, 349 (S.C. Ct. App. 1988) (reasonableness); *Whatley v. City of Dallas*, 758 S.W.2d 301, 308 (Tex. App.—Dallas 1988, writ denied) (reasonable care); *Tyler v. Grange Ins. Ass'n*, 473 P.2d 193, 199 (Wash. Ct. App. 1970) (good faith and ordinary care).

118. This is, in fact, how courts in what was, until recently, my home state of Kansas have resolved this issue. *Guarantee Abstract & Title Co. v. Interstate Fire & Casualty Co.*, 652 P.2d 665, 667 (Kan. 1982); see Robert H. Jerry, II, *Recent Developments in Kansas Insurance Law: A Survey, Some Analysis, and Some Suggestions*, 32 KAN. L. REV. 287, 300-05 (1984) (analyzing the *Guarantee* decision and an insurer's sub-duty to defend).



"implied in law." The same could be said of the duty of good faith. With due respect for the Romans,<sup>119</sup> contracting parties do not normally insert into their agreements an express provision that they will act in good faith. As such, it was a small step to the assertion that the duty of good faith, because it is not normally part of an express agreement, must be implied by courts—that is, implied by law. If one clouds the issue further with an assumption that duties expressed by the parties are contract duties, and duties implied by law are tort duties,<sup>120</sup> one can easily turn the duty to settle and the duty of good faith and fair dealing into tort duties. This is, of course, illogical; courts imply terms in contracts for all kinds of reasons, and these implied terms create contract duties, not tort duties.

Because liability policies promise the insured a defense of a covered claim, the contractual undertaking of the insurer is fundamentally a promise to act as a fiduciary, and breaches of fiduciary duties can be remedied in tort.<sup>121</sup> From this, it is a small step to the conclusion that the insurer's breach of its contractual undertaking, given its fiduciary aspects, must give rise to a tort claim.<sup>122</sup> Contract law, however, does not require this

119. See *supra* text accompanying notes 15-26.

120. See *Findley v. Time Ins. Co.*, 573 S.W.2d 908, 908 (Ark. 1978) ("[A]n insurance company, in addition to its liability on the contract, may also be liable to its insured in tort for breach of an implied duty to deal fairly and in good faith with the insured in the settlement of a claim under the policy."); *Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co.*, 375 A.2d 428, 430 (Conn. Super. Ct. 1977) ("The duty violated arises not from the terms of the insurance contract but is a duty imposed by law, the violation of which is a tort."); *Mauldin v. Sheffer*, 150 S.E.2d 150, 154 (Ga. Ct. App. 1966) ("[I]n order to maintain an action ex delicto because of a breach of duty growing out of a contractual relation the breach must be shown to have been a breach of a duty imposed by law and not merely the breach of a duty imposed by the contract itself."); *Palmieri*, *supra* note 8, at 105 (arguing that the duty of good faith "has become the object of a tug-of-war between those who seek its restriction to the realm of contract law . . . and those who envision the duty as the source of a tort remedy," and that the duty of good faith "is a duty imposed by law, and is outside the contractual freedom of the parties").

121. See, e.g., *Moore v. Regents of Univ. of Cal.*, 793 P.2d 479, 486 (Cal. 1990) (providing a cause of action for the breach of a doctor's fiduciary duty to a patient); *Destefano v. Grabrian*, 763 P.2d 275, 289 (Colo. 1988) (Quinn, C.J., concurring) (emphasizing that the breach of a fiduciary duty lies in tort); *Broadway Nat'l Bank v. Barton-Russell Corp.*, 585 N.Y.S.2d 933, 945 (Sup. Ct. 1992) ("Pleading a fiduciary duty is appropriate where a plaintiff, even if claiming a breach of contract, desires a remedy in tort for betrayal and breach of trust."); RESTATEMENT (SECOND) OF TORTS, § 874 cmt. b (1979) ("A fiduciary who commits a breach of his duty as a fiduciary is guilty of tortious conducts to the person for whom he should act. . . . [I]rrespective of [whether the action is in equity or at law], the beneficiary is entitled to tort damages for harm caused by breach of a duty arising from the [fiduciary] relation."); 2 DAN B. DOBBS, LAW OF REMEDIES: DAMAGES—EQUITY—RESTITUTION, § 10.4, at 668 (2d ed. 1993) ("[A] breach of fiduciary relationship . . . can amount to a tort . . .").

122. See *Campbell v. State Farm Mut. Auto. Ins. Co.*, 840 P.2d 130, 137-38 (Utah Ct. App. 1992) ("In the third-party context . . . the insurer owes a 'fiduciary duty to its insured . . .'. Accordingly, Utah law allows an insured to sue an insurer in tort to remedy a violation of that duty." (citation omitted)); *Farris v. United States Fidelity and Guar. Co.*, 587 P.2d 1015, 1019 (Or. 1978) ("[T]he insurance company is charged with acting in a fiduciary capacity as an attorney in fact representing the insured's interest in litigation. . . . [A]rguably, acting in its own interests to the detriment of the insured's interest while acting in such a fiduciary capacity is a tort.").

answer. The insurer *promises* to provide a defense, and while one might use a tort standard to determine when the duty has been breached, it does not follow that the remedy for the breach must be in tort.<sup>123</sup>

The more substantial issue is the economic one. A court looking at a set of facts in which the insurer has intentionally taken a position on coverage, defense, or settlement that causes serious harm and distress to the insured is ripe for being convinced that contract remedies are insufficient to deter this kind of insurer overreaching, and that the insurer's breach of contract must be treated as a tort, or else the insurer will have "too little incentive to perform because the contract would be under-enforced."<sup>124</sup> These arguments have a persuasive ring: The insurer declined to defend, knowing that if it were later found to have breached this duty, the contract damages would be the cost of defense, which is what the insurer would have expended anyway. The insurer declined to pay, knowing that if it were later found to have breached this duty, the contract damages would be the insured's loss, which is what the insurer would have paid anyway. The insurer declined to settle, and the risk to the insurer of an excess judgment was, by itself, insufficient to deter the insurer from trading on the insured's economic (and perhaps emotional) well-being. The argument concludes as follows: By offering the insured a remedy in tort, in which contract law's limitations on consequential damages are liberalized and punitive damages are available, the balance is shifted to protect the insured and deter the insurer from overreaching.

Contract law, however, is not so unsympathetic to the insured's plight. Contract law will provide the insured with a remedy for loss of bargain,<sup>125</sup> meaning that the insurer will have to provide a substitutional remedy equal in value to the performance it promised and did not deliver, whether this be defense costs or payment of proceeds. Contract law will provide the insured with a remedy for consequential loss,<sup>126</sup> meaning that the insurer will pay for the excess judgment resulting from the failure to settle. I have argued elsewhere that emotional distress resulting from an insurer's nonperformance is foreseeable at the time of contracting in many insurance transactions,<sup>127</sup> and contract law is flexible enough, if properly applied, to provide a remedy for this kind of loss. Finally, if one fears the

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123. See Powers, *supra* note 3, at 1230 n.71 (arguing that contract law should control the computation of damages in bad faith cases).

124. Mark Gergen, *A Cautionary Tale About Contractual Good Faith in Texas*, 72 TEX. L. REV. 1235, 1251 (1994).

125. FARNSWORTH, *supra* note 113, § 12.9, at 879.

126. *Id.* § 12.9, at 880.

127. Robert H. Jerry, II, *Remedying Insurers' Bad Faith Contract Performance: A Reassessment*, 18 CONN. L. REV. 271, 298-301 (1986) (pointing out that not only are insurers aware that insurance protects against the emotional distress that accompanies financial loss, but that they also emphasize the emotional effects of casualties in marketing insurance policies).

open-ended nature of emotional distress damages due to difficulties of calculation, or if one still considers contract law too limited to deter insurers' breaches when an obligation to perform is owed, a minor repair of contract law's remedial scheme is possible. Many states permit the aggrieved insured to recover attorneys' fees when the insurer fails to pay proceeds, and this permission could be extended to the insured who successfully claims that the insurer has breached the duty to defend or settle.<sup>128</sup> If one more turn of the ratchet is needed, a liquidated statutory penalty, which is found in some states, could be added to the underlying contractual remedy.<sup>129</sup>

Because I agree with Professor Powers that tort law is not a co-equal paradigm with contract law,<sup>130</sup> I conclude that tort law has infringed upon contract law's rightful territory. When the tort of bad faith emerged, its proponents were not forced to carry the burden of showing that the contract paradigm was incapable of fairly balancing the interests of insurer and insured. The tort was blessed despite a two-thousand-year tradition recognizing the duty of good faith to be first, foremost, and fundamentally a contractual undertaking and providing contract remedies for its breach.

### III. Some Thoughts on the Future of Bad Faith

I agree with Professor Abraham that the climate of bad faith liability seems calmer now than in the past.<sup>131</sup> But if we have adjusted our behavior in ways that make profound environmental changes seem less important than they were ten, twenty, or thirty years ago, we could easily overestimate the magnitude of the climate's shift. In other words, it is difficult to know to what extent the climate has changed and to what extent we now dress differently to deal with changed weather.

Professor Abraham is clearly correct that ERISA preemption of common law tort and contract actions has reduced bad faith litigation.<sup>132</sup> But ERISA's preemptive power may not be secure indefinitely. With respect to employer-provided health benefits in particular, the Clinton Administration's proposed National Health Security Act<sup>133</sup> apparently would limit ERISA's preemptive effect to employers and health benefit plans in

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128. See *id.* at 319-20 (arguing that an expansion of the existing statutory remedies would deter breaches of the duty to defend or settle); Gergen, *supra* note 124, at 1252 (observing that "fee-shifting increases the expected cost of a breach to a promisor").

129. See Gergen, *supra* note 124, at 1255-56 (citing Texas's 18% statutory penalty rate as one of the most effective ways to protect insureds). To borrow from Professor Powers, rather than supplant the contract paradigm with a tort paradigm, one should append a regulatory paradigm to the contract paradigm. Powers, *supra* note 3, at 1231 n.74.

130. Powers, *supra* note 3, at 1224.

131. Abraham, *supra* note 1, at 1295.

132. *Id.* at 1298-1300.

133. S. 1757, 103d Cong., 1st Sess. (1993), available in LEXIS, Legis Library, BILLS File.

corporate alliances, meaning that ERISA would not preempt employers and insurers operating through regional alliances.<sup>134</sup> This would mean that employees of companies with less than 5000 employees would be able to pursue bad faith claims against insurers of these plans in state court.<sup>135</sup> Whether the Clinton plan or this aspect of it will ever come to pass is an open question, and health care benefit plans are only one part of a much larger landscape, but the Clinton initiative reminds us of the tenuous nature of ERISA preemption.

As Professor Abraham states, the field of bad faith liability has had time to mature,<sup>136</sup> but as a field matures, those who plow it sometimes adjust what they plant in it. Insurers can presumably make better predictions about which bad faith claims are likely to create liability, and insurers can use their experience to adjust their rates and spread the costs among all policyholders. I am inclined to think that a bad faith count is included in most claims against insurers in jurisdictions that recognize the tort. We must assume that the count adds a premium to whatever value the claim has, and this suggests that the overall, system-wide cost of recognizing the tort of bad faith may be large, even if insurers are now able to better identify and redistribute these costs. My intuition is that treating insurer bad faith as a contract breach and invoking contract remedies would give insurers more certainty about outcomes, which in turn would reduce system-wide costs. But as Professor Abraham explains, the problem is that we simply do not know enough about the magnitude of any of these costs or effects.<sup>137</sup>

So the orienteer who has led us to the wrong side of the mountain explains that she has a hunch about what direction we should now take.

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134. Part 4 of Subtitle D of Title I of S. 1757 pertains to corporate alliances, *id.* §§ 1381-1398, whereas Part 2 of the Subtitle pertains to regional alliances. *Id.* §§ 1321-1340. A corporate alliance is defined as an "eligible sponsor" if the sponsor elects to be treated as a corporate alliance and certain conditions pertaining to the election are satisfied. *Id.* § 1311(a). The principle kind of eligible sponsor for a corporate alliance is a "large employer," *id.* § 1311(b)(1)(A), which is defined, essentially, as "an employer that has more than 5,000 full-time employees in the United States." *Id.* § 1311(e)(2). Section 1392 indicates that the civil enforcement provisions of § 502 of ERISA "shall apply to enforcement by the Secretary of Labor of this part in the same manner and to same extent as such provisions apply to enforcement of title I of such Act." *Id.* § 1392. It was the civil enforcement scheme in § 502 that was held to be exclusive in *Pilot Life Insurance Co. v. Dedaux*, 481 U.S. 41 (1987), and it presumably follows that the drafters of S. 1757 intended this remedial scheme to be exclusive with respect to claims to enforce the requirements of the proposed act. There is no provision equivalent to § 1392 in Part 2 for regional alliances, which presumably means that the remedial scheme of § 502 of ERISA is not exclusive with respect to the claims of employees who are not employed by "large employers" or by large employers that do not elect to become sponsors of a corporate alliance.

135. For further discussion, see Arnold R. Levinson, *Defining "Medically Necessary" and Clarifying Dispute Procedures Are Key to the Plan's Success*, NAT. L.J., Oct. 11, 1993, at S8; Robert C. Macaulay, Jr., *For Employers Participating in "Regional Alliances," Pre-emption of State Laws Would be Gone*, NAT. L.J., Oct. 11, 1993, at S9.

136. Abraham, *supra* note 1, at 1295.

137. Abraham, *supra* note 1, at 1315.

We know little about the consequences of this choice, and it is too late to go back. But somehow, as experienced participants in the process of legal change, we know we have been here before.